# Elbit Systems Ltd.
# Management's Report
# For The Quarter Ended march 31, 2001

**This report should be read together with the Company's reviewed financial statements for the quarter ended March 31, 2001 and the Company's Form 20- F for the year ended December 31, 2000, filed by the Company with the U.S. Securities and Exchange Commission and the Israeli Securities Authority.**

## A. The Company and its Business Environment

Elbit Systems Ltd. (the "Company") operates in the area of upgrading existing airborne, ground and naval defense platforms and is engaged in projects involving the design, development, manufacture, integration and marketing of integrated defense systems, electronic systems, electro-optic products and systems, software intensive programs and products for the defense and paramilitary sectors. In addition, the Company provides support and services for such platforms, products and systems.

The Company provides solutions for Western as well as former Eastern bloc equipment. It is engaged in the design, development, manufacture and integration of electronic and electro-optic systems and products for various leading projects in Israel and worldwide, such as ground and naval command, control and communication ("C³") systems, digital maps, night vision systems, pilot helmet mounted systems, display and data processing systems, unmanned air vehicles ("UAVs"), computerized simulators, communication systems, thermal imaging products, laser products, optical systems for space applications, airborne reconnaissance systems, optic communication products and systems, security products and systems, and electric drive systems. The Company often cooperates with industries in Israel, as well as in the countries of its other customers.

## B. Reporting According to Generally Accepted Accounting Principles in the United States ("US GAAP")

Following the approval by the Company's shareholders and option holders, the Company adopted, commencing with the fourth quarter of 2000, US GAAP as its accounting principles used for its financial statements, which were previously prepared under Israeli GAAP. The financial statements of the Company for the first three quarters of 2000, which were previously prepared in accordance with Israeli GAAP, have been readjusted for comparison purposes.

## C. Backlog of Orders

As of March 31, 2001, the Company's backlog of orders reached $1,502 million, of which 67% were for orders outside Israel. On December 31, 2000, the Company's backlog was $1,437 million, of which 71% were for orders outside Israel.

Approximately 70% of the Company's backlog as of March 31 2001 is scheduled to be performed in the next three quarters of 2001 and in the year 2002.

## D. Major Subsidiaries and Affiliated Companies

- El-Op Electro-Optics Industries Ltd. ("El-Op") - a wholly owned subsidiary of the Company registered in Israel, a leading company in the fields of advanced electro-optical products for defense, paramilitary and civil applications. El-Op's main business areas include development and production of thermal imaging products, laser products, optical systems for space applications, airborne reconnaissance systems, optical communications systems, fire control systems for combat vehicles and security products and other systems.

- EFW Inc. ("EFW") – a wholly-owned subsidiary of the Company, registered in the United States, serving as the base for the group's activities in the United States, mainly in the area of development, production and maintenance of advanced defense products and systems.

- Cyclone Aviation Products Ltd. ("Cyclone") -Wholly owned subsidiary registered in Israel. Cyclone provides logistic support and maintenance services for aircraft and helicopters, and manufactures structure components and sub-assemblies for aircraft.

- Ortek Ltd. ("Ortek") – 75.1% owned subsidiary registered in Israel, engaged mainly in the area of security products and systems and night vision equipment.

- Silver Arrow – a limited partnership registered in Israel, wholly owned by the Company and a wholly owned holding company engaged in the business of UAV systems and products.

- Semi-Conductor Devices ("SCD") – an Israeli partnership owned 50% each by the Company and Rafael Armaments Development Authority ("Rafael"), engaged in the development and production of semiconductor devices and lasers.

- Opgal Optronic Industries Ltd. ("Opgal") – an Israeli company, owned 50.1% by the Company and 49.9% by Rafael. Opgal is engaged mainly in the area of enhanced vision systems.

- Kinetics Ltd. ("Kinetics") - an Israeli company, 51% owned by the Company, involved in the development and production of systems for armored vehicles.

- First and sub-tier holdings, in several technology spin-off companies whose activities are mainly based on technologies that were developed in the Company and its subsidiaries. The spin-off Companies are involved mainly in the areas of optical communications, space and medical diagnostic equipment.

## E. Results of Operation

### 1. Special Events which affected the Business Results

**a.** The El-Op merger which was completed on July 5, 2000, was accounted for under the purchase method. As a result of the merger, the amount of $83 million (net of $14 million in deferred taxes) was attributed to technologies, know-how, trade names, work force and goodwill, and is amortized on a straight-line basis over their 7 to 25 year-estimated life. The weighted average period of amortization was determined to be 17 years, and the amortization expenses are reflected in the cost of sales and in the general and administrative expenses.

**b.** Following completion of the merger, the Company's management adopted in the third quarter of 2000 a program for organizational changes aimed at increasing the efficiency and maximizing the utilization of the resources at the Company's disposal and the synergies resulting from the merger. The Company accrued $22.1 million (before tax) for expense estimated by the Company to be required for the plan.

## 2. Summary of Financial Results

The following table sets forth the consolidated income statement of the Company and its subsidiaries for the three-month periods ended March 31, 2001 and March 31, 2000.

| | For the three months ended March 31 | | | |
|---|---|---|---|---|
| | 2001 | | 2000 | |
| | $ | % | $ | % |
| | (In thousands of U.S. dollars except per share data) | | | |
| Total revenues | **181,745** | 100.0 | **107,014** | 100.0 |
| Cost of revenues | **129,198** | 71.1 | **76,694** | 71.7 |
| Gross profit | **52,547** | 28.9 | **30,320** | 28.3 |
| Research and development expenses, net | **13,995** | 7.7 | **8,796** | 8.2 |
| Marketing and selling expenses | **14,172** | 7.8 | **8,454** | 7.9 |
| General and administrative expenses | **8,386** | 4.6 | **4,468** | 4.2 |
| | **36,553** | 20.1 | **21,718** | 20.3 |
| Operating income | **15,994** | 8.8 | **8,602** | 8.0 |
| Finance income (expenses), net | **(899)** | (0.5) | **1,013** | 0.9 |
| Other income, net | **185** | 0.1 | **169** | 0.2 |
| Income before income taxes | **15,280** | 8.4 | **9,784** | 9.1 |
| Provision for income taxes | **3,807** | 2.1 | **2,058** | 1.9 |
| | **11,473** | 6.3 | **7,726** | 7.2 |
| Minority interest | **3** | 0.0 | **234** | 0.2 |
| Company's share of affiliated companies and partnerships losses | **(839)** | (0.4) | **(223)** | (0.2) |
| Net earnings | **10,637** | 5.9 | **7,737** | 7.2 |
| Diluted earnings per share | **0.28** | | **0.29** | |
| Amortization of excess of cost over book value related to mergers and Acquisitions | **1,658** | **0.9** | **272** | 0.3 |
| Net earnings excluding amortization of Excess of cost over book value | **12,295** | 6.8 | **8,009** | 7.5 |
| Diluted earnings per share excluding Amortization of excess of cost over book value | **0.32** | | **0.30** | |
| Weighted average Number of shares used in computation | **38,611** | | **26,741** | |

**3. First Quarter of 2001 Compared with the First Quarter of 2000**

## Revenues

The Company's revenues are segregated by lines of business and the geographic regions in which it operates.

The consolidated revenues increased from $107 million in the first quarter of 2000 to $181.7 million in the first quarter of 2001. The main reason for the change in revenues was the consolidation of the revenues of El-Op and the subsidiaries held by El-Op prior to the merger, starting in the third quarter of 2000.

The following is the revenue distribution by business lines:

| | Three-Month Period ended | |
|---|---|---|
| | March 31, 2001 | March 31, 2000 |
| | (In $ millions) | |
| Airborne systems | 75.9 | 58.4 |
| Armored vehicles systems | 27.7 | 22.0 |
| $C^3$ systems | 26.2 | 26.0 |
| Electro-Optics | 40.4 | * |
| Other | 11.5 | 0.6 |
| Total | 181.7 | 107.0 |

* not material

Following is the revenue distribution by geographical regions:

| | Three-Month period ended | |
|---|---|---|
| | March 31, 2001 | March 31, 2000 |
| Israel | 28% | 31% |
| United States | 26% | 30% |
| Europe | 23% | 31% |
| Other Countries | 23% | 8% |

**Gross Profit**

Gross profit, was $52.5 million in the quarter ended March 31, 2001 as compared to $30.3 million in the quarter ended March 31, 2000. The gross profit margin in the quarter ended March 31, 2001 was 28.9% as compared to 28.3% in the quarter ended March 31, 2000.

The changes in the gross profit resulted mainly from the consolidation of El-Op and subsidiaries held by El-Op prior to the merger starting in the third quarter of 2000. The cost of goods sold includes amortization of excess of cost over book value of intangible assets related to the mergers and acquisitions.

**Research and Development**

As a company whose main business is the development of advanced technologies, products and systems, the Company invests in research and development, in accordance with a long- term plan, based on estimated market needs.

Gross research and development expenses in the quarter ended March 31, 2001 totaled $17.0 million (9.3% of revenues), as compared to $9.9 million (9.3% of revenues) in the quarter ended March 31, 2000. Net research and development expenses (after deduction of the Government of Israel Chief Scientist participation) in the quarter ended March 31, 2001 totaled $14.0 million (7.7% of revenues), as compared to $8.8 million (8.2% of revenues) in quarter ended March 31, 2000.

The Company's R&D expenses in the reported periods were in accordance with the Company's long-term plan. The changes in the R&D expenses in the quarter ended March 31, 2001 was due mainly to the inclusion, for the first time in the third quarter of 2000, the expenses of El-Op and the subsidiaries held by El-Op prior to the merger.

**Marketing and Selling Expenses**

Marketing and selling expenses in the quarter ended March 31, 2001 were $14.2 million (7.8% of revenues) as compared to $8.5 million (7.9% of revenues) in the quarter ended March 31, 2000.

The change in the expenses was due mainly to the inclusion of the expenses of El-Op and the subsidiaries held by El-Op prior to the merger starting in the third quarter of 2000.

**General and Administration Expenses**

General and administrative expenses, in the quarter ended March 31, 2001, were $8.4 million (4.6% of revenues), as compared to $4.5 million (4.2% of revenues) in the quarter ended March 31, 2000.

The changes in the G&A expenses in the quarter ended March 31, 2001 resulted mainly from the consolidation of El-Op and subsidiaries held by El-Op prior to the merger starting in the third quarter of 2000. The G&A expenses include amortization of excess of the cost related to mergers and acquisitions.

**Operating Income**

As a result of all of the above, operating income totaled $16.0 million in the quarter ended March 31, 2001, as compared to $8.6 million in the quarter ended March 31, 2000.

The operating profit margin increased from 8.0% in the quarter ended March 31, 2000 to 8.8% in the quarter ended March 31, 2001.

**Finance income (expenses), Net**

Finance expenses, net, in the quarter ended March 31, 2001 was $0.9 million, as compared to $1.0 million finance income in quarter ended March 31, 2000.

The change in the finance expenses, net, was caused mainly by an increase in the Company's loans, principally as a result of the consolidation of El-Op and its subsidiary companies starting in the third quarter 2000.

**Income Before Tax**

Income before tax in the quarter ended March 31, 2001 was $15.3 million (8.4% of revenues) as compared to $9.8 million (9.1% of revenues) in the quarter ended March 31, 2000.

**Taxes on Income**

Provision for taxes for the quarter ended March 31, 2001 was $3.8 million (effective tax rate of 25%) as compared to $2.1 million (effective Tax rate of 21%) in the quarter ended March 31, 2000.

**Net Earnings and Earnings Per Share ("EPS")**

Net earnings in the quarter ended March 31, 2001 before amortization of excess of cost over book value related to the mergers and acquisitions (net) was $12.3 million (6.8% of revenues), as compared to $8.0 million (7.5% of revenues) in the quarter ended March 31, 2000.

Fully diluted EPS in the quarter ended March 31, 2001 before amortization of excess of cost over book value related to the mergers and acquisitions (net) was $0.32, as compared to $0.30 in the quarter ended March 31, 2000.

Net earnings after amortization of excess of cost over book value related to the mergers and acquisitions in the quarter ended March 31, 2001 was $10.6 million (5.9% of revenues) as compared to $7.7 million (7.2 % of revenues) in the quarter ended March 31, 2000.

Fully diluted EPS after amortization of excess of cost over book value related to the mergers and acquisitions in the quarter ended March 31, 2001 was $0.28, as compared to $0.29 in the quarter ended March 31, 2000.

The number of shares used for computation of fully diluted EPS in the quarter ended March 31, 2001 was 38,611 thousand shares as compared to 26,741 thousand shares in the quarter ended March 31, 2000. The increase in the number of shares was due mainly to share issuance made in connection with the El-Op merger.

**4**. **Liquidity and Capital Resources**

The Company's cash flow is effected by the cumulative cash flow of its various projects in the reported periods. Projects' cash flows are effected by the timing of the receipt of advances and the collection of accounts receivable from customers, which relate to specific events during the project, while expenses are on-going.

The Company's policy is to invest its cash surplus primarily in interest bearing deposits, in Accordance with its projected needs.

The resources available to the Company include mainly profits, collection of account receivable, advances from customers, and Government of Israel programs, such as the Chief Scientist and development grants. In addition, the Company has access to bank credit lines in Israel and abroad based on its capital, assets and activities. The Company also has the ability to raise funds through the offering of shares and debentures to the public from time to time.

The Company's net cash flows derived from ongoing operations in the quarter ended March 31, 2001 was $12.4 million, resulting mainly from the net earnings in the reported

period, non cash expenses and decrease in accounts receivable which were partly offset by increase by inventories and decrease in accounts payable.

Net cash flow used for investments activities in the quarter ended March 31, 2001 was $11.9 million, which was used mainly for procurement of fixed assets.

Net cash flow used for financing activities in the quarter ended March 31, 2001 was $7.0 million, which was used mainly for repayment of short and long term debts and repurchase of the Company's shares.

## 5. Primary Risk Factors

Please refer to the Company's Form 20-F for the year 2000, filed by the Company with the U.S. Securities and Exchange Commission and the Israeli Securities Authority.

## 6. Derivatives and Hedges

On March 31, 2001, the Company had exposure due to liabilities denominated in New Israeli Shekels ("NIS") of $29 million in excess of its NIS denominated assets.

Most of the Company's assets and liabilities which are denominated in currencies other than the NIS and the US Dollar, were covered as of March 31, 2001, by financial instruments (mostly forward contracts).

On March 31, 2001 the Company had contracts for the sale and purchase of such foreign currencies totaling $17.6 million. The results from the activity in financial instruments for the reported period was not material.

## 7. Dividends

The Board of Directors declared on May 7, 2001 a dividend of $0.08 per share for the first quarter of 2001.

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Forward looking statements with respect to the Company's business, financial condition and results of operations in this document are subject to risks and uncertainties that could cause actual results to differ materially from those contemplated in such forward looking statements, including, but not limited to, product demand, pricing, market acceptance, changing economic conditions, risks in product and technology development, the effect of the Company's accounting policies as well as certain other risk factors which are detailed from time to time in the Company's SEC filings.

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